

Restructuring a Local Utility

L'viv, Ukraine

Background

The municipally-owned water and wastewater service enterprise (*Vodokanal*) of L'viv (population 798,000) and its customers were facing serious problems. Residents of L'viv received water service an average of six hours a day. The *Vodokanal* was insolvent: its bills were not based on full cost recovery; it collected less than 70 percent of its billings; and half its collections were in the form of payments in kind rather than cash. The *Vodokanal* had a large and growing debt to its suppliers, principally the local electric utility. The rate structure resulted in an unsustainable cross-subsidy of residential customers by industry and enterprise customers. Political considerations prevented *Vodokanal* management from increasing tariffs to reflect the full cost of service and reducing or terminating service to customers who failed to pay their bills. The central government was no longer able to finance capital repairs and investments, and neither the City of L'viv nor the *Vodokanal* were able to finance them from their own revenues or to attract loans or investments from other sources. Also, under Ukrainian law, privatization of *Vodokanals* was prohibited.

Innovation

City officials and *Vodokanal* representatives together with outside experts created an interdepartmental task force to develop consensus regarding the restructuring process. The task force held numerous workshops and seminars to lessen the effect of frequent personnel changes, disseminate knowledge about the existing problems, and achieve consensus on possible solutions. The local officials agreed to:

- create an autonomous, financially self-sustaining water and wastewater services company.
- engage, through a competitive international tender, a private operator to manage the restructured utility.
- clarify the respective rights and obligations of the city and the restructured utility through a performance agreement setting levels of service, tariff policies, billing and collection policies, capital repair and investment policies, etc.

The task force views the creation of an autonomous utility company as essential to providing water and wastewater services in L'viv in a financially self-sustaining manner. The utility will be restructured as a joint stock company, and the city will lease the operating assets to the company to comply with Ukrainian law. Assets other than the "core production assets" may be sold to the new company.

Results

The city and the *Vodokanal* are now implementing the institutional changes that have been agreed on by local officials. The initial project design, studies, proposal preparation, and implementation will take 22 months and cost approximately \$300,000. Although the L'viv City Council will not make a decision on the proposed restructuring until the middle of 1997, a number of positive results of the project are already apparent. *Vodokanal* officials have evaluated cost recovery problems and have implemented a number of measures that have already resulted in significant improvements. In addition, local officials have begun to take a longer-term view of financial and budgeting issues than was common under the Soviet system. Moreover, city and *Vodokanal* officials have begun to actively debate the merits of making fundamental changes in the way water and wastewater services are delivered.

Summary

To alleviate its financial and service delivery problems, the municipally-owned water and wastewater utility in L'viv is being restructured from a state enterprise to an independent joint stock company whose relationship with the municipality will be clearly defined by contract. Restructuring will enable the utility to achieve greater cost recovery, improve its capital investment procedures, attract capital financing, and improve water and wastewater services for the citizens of L'viv.

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